Do Employees Owe a Fiduciary Duty to their Company?

written by Conner Lantz | September 27, 2023

Maybe you've played the computer game about the ninja master who shares his deepest warrior secrets with a young apprentice only to see the apprentice join up with his arch-enemy? The master's challenge is to somehow prevent the apprentice from using the training and knowledge he's gained to destroy the master. This game is pretty good preparation for being an HR director. Like the ninja master, companies often entrust their most precious secrets to their employees. And sometime those employees take that information and use it to compete against the employer, the way the deceitful apprentice does in Ninjaland.

As HR director, you need to understand this risk and help insulate your company against it. But in the real world, you don't fight back against former employees who turn on you with shuriken (those razor-sharp star-shaped projectiles that ninjas hurl at their foes), swords and gravity-defying acrobatics. Your weapons are the more mundane instruments of law. But, like the ninja weapons, legal instruments take some degree of mastery to wield. This article will help you use one of these weapons: the fiduciary duty theory.

What the Law Requires

What legal basis do you have to prevent departing employees from joining a rival firm or opening their own business and using what they've learned from your company to compete against you? Generally, a company's first line of defence is the employment contract. The two most common so-called "restrictive covenants" that employers rely on are:

Non-Compete Clauses

Employees must be loyal to their employers throughout the employment relationship. But once they leave the company, they're free to compete. In non-compete clauses, employees agree to give up their rights to open a competing business or go to work for a competitor **after** they leave the company.

The Problem: Courts are reluctant to enforce non-compete clauses. Although they recognize the right of a company to protect its business from unfair competition, courts are also protective of employees' right to earn a living in their chosen field. In the eyes of most courts, non-competes go too far. In fact, one province, Ontario, has actually banned the use of non-competes in written employment contracts except for executives and in connection with the sale of a business (Ontario, *ESA*, Sec. 67.2).

According to the Canadian Supreme Court in what remains the leading case on non-compete clauses outside of Ontario: "A covenant in restraint of trade is enforceable only if it's reasonable. . . There is an important public interest in . . . maintaining free and open competition" [*Elsley v. J.G. Collins Insurance Agencies Ltd*., 1978 CanLII 7 (SCC), [1978] 2 SCR 916].

To be "reasonable," the non-compete must be limited in:

- Geographic scope;
- Scope of activities from which employee must refrain; and
- Time duration—generally, a non-compete can't last longer than 1 or 2 years.

Example: A computer software engineer helped create a source code program for managing juries while working for company that helps courts manage their operations. The engineer left the company and joined a rival firm. Soon after, the rival firm came out with a competing software product. The original company sued the engineer for breaching his non-compete. But the BC court ruled that the clause wasn't reasonable and refused to enforce it. The clause would prevent the engineer "from any involvement in servicing courts of law in ways unrelated to jury management or in any business that is substantially similar" to its own, the court explained [*ACS Public Sector Solutions Inc. v. Courthouse Technologies Ltd*., 2005 B.C.C.A. 605 (CanLII)].

Non-Solicitation Clause

The non-solicitation clause typically bans employees from soliciting business from your clients (and/or poaching away key employees) after they leave. Although they also restrict the employee's right to pursue a living after employment, non-solicitation clauses are decidedly more acceptable to courts than non-competes.

Example: The same BC court in the *ACS* case that said that the non-compete in the software engineer's contract went too far ruled that a non-solicitation clause was okay. So, the court severed, that is, removed the non-compete covenant and enforced the non-solicitation one.

The Problem: Courts won't enforce non-solicitation clauses if they're too broad or vague. For example, an Ontario court struck down a clause that barred an employee from soliciting clients that he "dealt" with at the firm because the agreement didn't define "dealing with" [*Syntax Systems Ltd. v. Mid-Range Computer Group Inc.,* 2003 CanLII 29363 (ON S.C.)]. Another Ontario court ruled that not letting a former employee solicit "prospects," defined to include not just clients the employee dealt with but potential clients of the firm with whom he had no dealings, went too far [*IT/NET Ottawa Inc. v. Berthiaume*, 2003 CanLII 21072 (ON S.C.)].

An Alternative Strategy: Fiduciary Duty

We're not suggesting that restrictive covenants aren't important or that you shouldn't use them. But what we are suggesting is that they're not 100% reliable. Consequently, employers need a backup. A common fallback position is to use a legal theory "fiduciary duty." There are 2 things you must prove to use this theory to prevent a former employee from competing against you.

1. The Employee Is a Fiduciary

First, you must show that the employee actually is a fiduciary. Although a contract can also specify that an employee is a fiduciary, fiduciary duty is usually created not by contract language but through the application of common law, that is, law made by judges in deciding actual cases. Under the common law, all employees have an implied duty of loyalty to their employers. Employees are no longer required to be loyal to their employers after their employment ends. So, competing against a former employer doesn't violate the duty of loyalty.

But some employees owe their employers a higher duty of loyalty called a "fiduciary duty." Unlike the duty of loyalty, a fiduciary duty can continue after the employee leaves the company. Showing that an employee is a fiduciary is difficult. There's no precise definition of fiduciary. In the words of the Canadian Supreme Court, the existence of the duty "depends upon the reasonable expectations of the parties, and these expectations in turn depend on factors such as trust, confidence, complexity of subject matter and community or industry standards." However, there are characteristics that courts look for in determining if a fiduciary relationship exists:

- The employee occupies a position of trust;
- The employee has a lot of power or discretion over the company's legal or practical interests; and
- The company is peculiarly vulnerable to the employee.

Which Upper-Level Employees Are Fiduciaries?

Employees who occupy top executive or senior management positions are the most likely to owe fiduciary duties to their employers. The leading case on this issue was a ruling involving two senior management officials who left an aerospace company to set up a competing firm. Using the company's trade secrets and client lists, they then took for themselves a business opportunity that they were working on while at the original company. The Canadian Supreme Court ruled that the officers had breached a fiduciary duty to the company. As top management, these employees owed the company responsibilities that were "far removed from the obedient servant," the Court held. "Theirs was a larger, more exacting duty" [*Canadian Aero Service Ltd. v. O'Malley*, [1974] S.C.R. 592 (S.C.C.)].

Which Mid-Level Employees Are Fiduciaries?

Although it's much rarer, **mid-level** employees can also be fiduciaries if they're considered what's known as "key employees." The status of "key employee" isn't based on the employee's title but on factors such as the significance of the employees' functions, how much trust the company resides in him and whether the company is vulnerable because it relied on him.

2. Competition Violates Employee's Fiduciary Duty

Once you've proven that an employee owes your company a fiduciary duty, you must show that the act of competing against you violates that duty. **Explanation:** A "fiduciary" is supposed to not only act in good faith but exercise extra loyalty to protect the employer, even if it means putting the employer's interest ahead of their own, even after the employment relationship ends.

What this all means is that employees who are fiduciaries can't unfairly compete against their employers. **Caveat:** Remember that courts don't like to prevent employees, even fiduciaries, from pursuing a career in their chosen field. So, the ban on competition lasts for only a limited—or "reasonable"—amount of time. Lawyers suggest that 6 to 12 months is a good "ballpark" figure for "reasonable."

In addition, competition from a fiduciary is illegal only if it's "unfair." Although there are no precise boundaries or definition of "unfair competition," it generally involves the fiduciary's use of their previous position to gain an unfair advantage over the company. The cases reveal what kinds of conduct courts consider as crossing the line:

Taking Away a Business Opportunity. The most obvious form of unfair competition by a fiduciary is to misappropriate a business opportunity that belongs to the previous company. So, for example, suppose employees are working to secure a lucrative government contract and then open their own firm just as the contract is to be awarded. Persuading the government to divert the contract to their new business would likely be a breach of fiduciary duty.

Misuse of Confidential Information. Fiduciaries are supposed to safeguard the confidentiality of the company's sensitive information, not misappropriate it for their own benefit. To persuade a court that a fiduciary is misuse of such information, the company must generally prove 3 things:

- The information was confidential;
- The fiduciary was given the information in confidence and with an obligation to keep it confidential; and
- The fiduciary used the information to help themselves and hurt the company.

Caveat: Fiduciaries are, however, allowed to use the skill, knowledge and experience they've developed at the company after they leave. There's a big difference between taking a customer list and staying in touch with former clients.

Wooing Away Key Personnel or Customers. Soliciting other important employees—either by inducing them to quit or offering them jobs—is another form of unfair competition that's inconsistent with an employee's fiduciary duties. The same is true of directly poaching a customer. Employees who engage in such behaviour may also be liable of committing another kind of tort, or common law offence, known as inducing a breach of contract. "There's a duty not to interfere improperly with a contractual relationship," explains an Alberta employment lawyer. "Inducing a breach is a separate grounds for damages against the former employee," she adds.

Takeaway

Breach of fiduciary duty is no substitute for well drafted confidentiality clauses and covenants that impose clear and reasonable restrictions on the right of an employee to compete after leaving the firm. But when those contractual obligations fail, as they sometimes do, resorting to the fiduciary duty theory can help you salvage the situation. Just recognize that the theory can only be used in limited circumstances and against certain kinds of employees and don't overplay your hand.